



Gulf Canada Corporation

Proposed Transfer of Shares of
The Consumers' Gas Company Ltd.
from Hiram Walker Resources Ltd.
to HWR Holdings Inc. and
685515 Ontario Inc.

E.B.R.L.G. 30

REPORT OF THE BOARD

REPORT OF THE BOARD

E.B.R.L.G. 30

IN THE MATTER OF the Ontario Energy Board
Act, R.S.O. 1980, Chapter 332, Section 26;

AND IN THE MATTER OF an Application by
Gulf Canada Corporation on behalf of its
wholly-owned subsidiary FWR Holdings Inc.
to the Ontario Energy Board for leave of
the Lieutenant Governor in Council under
Subsection 26(2) of the Ontario Energy
Board Act.

BEFORE:

R. W. Macaulay, Q.C.
Chairman and Presiding Member

M. C. Rounding
Member

O. J. Cook
Member

November 17, 1986



Ontario
Energy
Board

14 Carlton Street
Toronto, Ontario
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November 17, 1986

To His Honour the Lieutenant Governor in Council:

The Ontario Energy Board received an application from Gulf Canada Corporation on behalf of HWR Holdings Inc., seeking leave of the Lieutenant Governor in Council, pursuant to subsection 26(2) of the Ontario Energy Board Act, to transfer the interest of Hiram Walker Resources Ltd. in The Consumers' Gas Company Ltd. to HWR Holdings Inc., a new wholly-owned subsidiary of Gulf. A further request was made for approval to possibly transfer this interest to 685515 Ontario Inc., a new wholly-owned subsidiary of HWR Holdings Inc. After holding a public hearing to examine all evidence presented, the Board submits its Report and opinion herewith.

Respectfully submitted,

ONTARIO ENERGY BOARD

R.W. Macaulay, Q.C.
Chairman

M.C. Rounding
Member
O.J. Cook
Member

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1. INTRODUCTION

The Application

- 1.1 The Consumers' Gas Company Ltd. (Consumers'), with approximately 800,000 customers located mainly in the major cities in southern Ontario, is the province's largest natural gas distributor. A map of Consumers' distribution system is attached as Appendix A. Since 1981, 82.9 per cent of the outstanding shares of Consumers' have been owned by Piram Walker Resources Ltd. (HWR).
- 1.2 In April of this year, Gulf Canada Corporation (Gulf or the Applicant) acquired control of HWR and with it, Consumers'.
- 1.3 Gulf is a Canadian-owned natural resource company engaged in a wide range of oil and gas exploration, production and resource marketing

activities. Through its ownership of 83.4 per cent of Abitibi-Price, Inc. of Toronto, Ontario, Gulf is involved in the forest products industry. Gulf traces its history back to 1906, when The British American Oil Company, Limited was founded. In recent years it has operated as Gulf Canada Limited, a fully integrated energy company. Approximately 80 per cent of the outstanding shares of Gulf are beneficially owned by subsidiaries of Olympia & York Developments Limited (Olympia & York), a real estate development and investment holding company incorporated under the laws of the Province of Ontario. All the voting shares of Olympia & York are beneficially owned by Reichmann Holdings Limited, which is wholly-owned, directly or indirectly, by various members of the Reichmann family of Toronto, Ontario.

- 1.4 This Report is the result of an application dated September 16, 1986 (the Application) to the Ontario Energy Board (the Board) by Gulf on behalf of HWR Holdings Inc. (New HWR), seeking the leave of the Lieutenant Governor in Council pursuant to subsection 26(2) of the Ontario Energy Board Act (the Act) to approve the transfer of HWR's interest in Consumers' to New HWP, a new, wholly-owned subsidiary of Gulf. The Application also requested approval of a possible further transfer of this interest from New HWR to a wholly-owned subsidiary of New HWP.

which as of the date of the Application was yet to be incorporated. During the hearing, Gulf incorporated a new company, 685515 Ontario Inc., which entered into an agreement with New HWR whereby it would purchase all of the Consumers' shares held by New HWR if approval to do so was granted by the Lieutenant Governor in Council.

- 1.5 Appendix B contains diagrams outlining these steps in more detail including: (1) the present corporate structure of Gulf, including its subsidiaries and parent; (2) the proposed corporate structure following the Plan of Arrangement; and (3) the corporate structure following, inter alia, the dissolution of FWP and Walker-Home Oil Limited (WHO) and the implementation of the two share transfers requested in the Application.
- 1.6 As is obvious from the corporate organization charts, the purchase of HWR by Gulf has the result of including Consumers' in what is one of the largest corporate conglomerates in Canada. Through Gulf, Consumers' has now moved under the ownership umbrella of Reichmann Holdings Limited.
- 1.7 This Application however, was not specifically occasioned by that change of ownership, but rather by the intended reorganization of Gulf's

corporate structure and, as part of it, the transfer of Consumers' shares presently held by HWR to a new subsidiary of Gulf. These proposals trigger subsection 26(2) of the Act which reads as follows:

No person, without first obtaining the leave of the Lieutenant Governor in Council, shall acquire such number of any class of shares of a gas transmitter, gas distributor or storage company that together with shares already held by such person or by such person and an associate or associates of such person will in the aggregate exceed 20 per cent of the shares outstanding of that class of the gas transmitter, gas distributor or storage company.

1.8 In the Board's report dealing with the takeover of Union Enterprises Ltd. by Unicorp Canada Corporation, dated August 2, 1985 (the Union/Unicorp Report) the Board recommended changes to the Act such that pre-acquisition approval by the Board of a change of control of the parent or grandparent of a utility would be required. That recommendation (had it been implemented) would have prevented Consumers' parent (HWR) from being acquired by Gulf until the Lieutenant Governor in Council had given approval.

1.9 In determining whether it should recommend approval to the Lieutenant Governor in Council,

the Board examines among other factors, the effect of the proposed transfer on the public interest. The definition of public interest, insofar as it pertains to the ownership of a utility, was a central issue of both the Union/Unicorp Report and an earlier report concerning the acquisition of the shares of Northern and Central Gas Corporation Limited by Inter-City Gas Corporation (the Inter-City Gas Corporation Report). In the Union/Unicorp Report, the Board in looking at its role under section 26 of the Act identified several factors relating to the public interest, including:

- o the social contract which exists between the gas utilities and the Government;
- o the on-going regulation of the Ontario gas utilities by this Board;
- o undertakings from the utility and/or its parent and the enforcement of them; and
- o the free choice of individuals, corporations and institutions to invest in and to transfer investments in Ontario gas utilities or holding companies of gas utilities.

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The Hearing

Appearances

- 1.10 The following persons appeared before the Board during the course of the hearing:

G.E. Kaiser	Special Counsel
S.B. Sharpe	representing Gulf
W.N. Gula	and New HWR
R.S. Paddon, O.C.	representing
	Consumers'
L.D. Robinson	representing Union
	Gas Limited
F.W. Hurst	on behalf of himself

Witnesses

- 1.11 The following witnesses were called by Gulf to give evidence before the Board:

M.A. Cohen	Chairman of the Board, Gulf and President, HWR
L.G. Dodd	Vice President, Finance and Chief Financial Officer, Gulf
T.E. Kierans	President and Director, McLeod Young Weir Limited

- 1.12 Board staff called the following witnesses:

M.R. Irwin	Professor of Economics, University of New Hampshire
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B.I. Ghert

President and Chief Executive Officer, Cadillac Fairview Corporation

- 1.13 One intervenor made submissions before the Board:

F.W. Hurst

Self-employed

- 1.14 The hearing was held in Toronto commencing October 8, 1986 and lasted for five hearing days. Special Counsel and the Applicant submitted written argument to the Board on October 20, 1986. The Board received Gulf's reply argument on October 22, 1986 and Special Counsel's on October 23, 1986. Copies of those arguments, along with all exhibits filed during the hearing and verbatim transcripts of the proceeding are available for public inspection at the Board's offices. All of this material was reviewed by the Board and taken into account in making this Report.

- 1.15 The following chapters of the Report outline the circumstances surrounding the necessity for the Application; the issues which arose during the proceeding; the effect on the public interest of the Board's conclusions in regard to these issues; the enforceability of and signatories to the undertakings; a summary of the Board's conclusions and recommendations as to undertakings; and the recovery of costs of the hearing.

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2. THE BACKGROUND

Chronology of Events

- 2.1 Gulf's intention to purchase up to 26 million common shares of HWR at \$32 per share as well as all outstanding Class D preference shares, first series for \$28.63 per share was announced publicly on March 19, 1986. That proposal would have given Gulf control of HWR for about \$1.2 billion.
- 2.2 During the hearing, Mr. Cohen testified that Gulf made its decision to acquire HWR as a result of lower oil prices which are expected to cause Gulf some difficulties until the late 1980's or early 1990's when oil prices are forecast to increase. He testified that because of HWR's strong cash flow, Gulf expected that the acquisition would provide Gulf with the stability it desired until oil prices increased again.

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2.3 At the time, HWP had assets valued at \$5.7 billion and owned:

- o 82.9 per cent of Consumers';
- o 34.4 per cent of Interprovincial Pipe Line Limited (IPL), North America's longest crude oil and liquids pipe line company;
- o 100 per cent of Hiram Walker-Gooderman & Worts Limited (HW-GW), one of Canada's oldest distilling companies; and
- o 100 per cent of Home Oil Company Limited (Home Oil), which explores for and produces hydrocarbons, principally in North America, as well as owning pipe line and storage facilities.

2.4 Within days of the announcement, Gulf began buying HWR shares on both the Toronto and Montreal stock exchanges. HWR's Board of Directors formally rejected Gulf's offer and, among other actions, it proceeded to enter into a \$2.6 billion agreement with Allied-Lyons PLC (Allied-Lyons) of England for the sale of HWR's liquor business. Simultaneously, Fingas Investment Corporation (owned principally by HWR and Allied-Lyons) made a public offering for HWR shares which was \$8 per share more than Gulf's offer (the Fingas Offer).

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- 2.5 Olympia & York sought to block this sale to Allied-Lyons and the offer to purchase made by Fingas in an action filed in the Supreme Court of Ontario. Meanwhile, the Toronto Stock Exchange postponed the completion of the Gulf offer pending a full review.
- 2.6 By April 10th there was another offer from TransCanada PipeLines Limited (TCPL) which offered \$36.50 per share for all shares of HWR at a total cost in excess of \$4 billion. The Fingas Offer was withdrawn and the Board of Directors of HWR recommended acceptance of the TCPL offer. Two days later Gulf's offer was formally increased to \$38 a common share and \$34 for each Class D preference share. TCPL withdrew its offer and HWR's Board of Directors subsequently recommended that its shareholders accept the Gulf offer.
- 2.7 The agreement between Allied-Lyons and HWR called for Allied-Lyons to purchase 100 per cent of HW-GW for \$2.6 billion net of certain debt. Gulf brought an injunction proceeding before the Supreme Court of Ontario to stop this deal; the injunction was subsequently denied and Gulf appealed this decision to the Ontario Divisional Court.
- 2.8 HWR then commenced a separate legal action to declare its contract with Allied-Lyons of "no

force and effect". HWR claimed that the Allied-Lyons sale was conditional on the success of the acceptance of the Fingas Offer. Since that was not successful, HWR took the position that the sale of the liquor business was to be abandoned.

- 2.9 The Divisional Court rejected the appeal by Olympia & York. The HWR action was settled later by an agreement between Allied-Lyons and Gulf whereby the original sale would be completed on its original terms and Gulf would re-purchase a 49 per cent interest in HW-GW for a maximum of \$500 million.

Reorganization of Gulf

- 2.10 As part of its original offer for the HWR shares, Gulf proposed to combine the two companies thus permitting those shareholders who did not accept the original Gulf offer to participate in Gulf as well as in HWR. This Plan of Arrangement meant that the remaining persons still owning 7.1 per cent of the shares of HWR would be required to exchange their HWR shares for Gulf shares or to accept a cash payment for the purchase of their shares. Such an arrangement requires both court and shareholder approval, both of which have been given as of the date of this Report.

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- 2.11 Gulf proposes to dissolve HWR and distribute all of its assets; some are to be acquired by New HWR, some by various other companies held under the Gulf umbrella and some by Allied-Lyons. Gulf indicated that it could have transferred HWR's assets directly to Gulf upon the granting of the necessary approvals but chose to utilize the mechanism of New HWR because of the difficulties involved in meshing the terms of the various debt obligations of HWR with Gulf.
- 2.12 Following the completion of the Plan of Arrangement, Gulf proposes to transfer Consumers' to a new wholly-owned subsidiary of New HWR, namely 685515 Ontario Inc.
- 2.13 Gulf explained that the purpose of placing the numbered company between New HWR and Consumers' was to achieve business flexibility which might be hampered by pending changes in the tax system.
- 2.14 At the same time Gulf intends to dissolve WHO and distribute its assets to New HWR, its sole shareholder. The last steps in the reorganization are the selling of Home Oil to IPL and HW-GW to Allied-Lyons (following which Allied-Lyons will sell 49 per cent of HW-GW back to Gulf).

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- 2.15 Any guarantees of Consumers' debt or preference shares, formerly given by HWP, would now be assumed by New HWR, or replaced with a letter of credit from a Canadian chartered bank.
- 2.16 New HWR will not hold the same mix of assets that HWR held. The substantial differences are the sale of HW-GW and that Home Oil will cease to be a wholly-owned subsidiary; Home-Oil will be sold to IPL which will then be 34.4 per cent owned by New HWR and 6.5 per cent owned by Gulf.

3. ISSUES

3.1 As outlined in Chapter One, a change in the direct control of a utility requires the Board to examine the impact of the change on the utility and the public interest. In the case of Consumers', the Board has divided this evidence into a number of issues each of which has been assigned a separate section within this Chapter. Special Counsel and the Applicant each proposed undertakings to deal with these issues. The proposed undertakings are set out in Appendix C.

3.2 The conclusions of the Board and recommended undertakings in regard to a particular issue appear at the end of each section and the overall effect on the public interest is discussed in Chapter Four.

Financial Soundness of Parent

3.3 The financial soundness of Consumers' parent (New FWR or 685515 Ontario Inc.) and its owner (Gulf) is an important issue to be considered in assessing both the effect of a change in ownership on the public interest generally and on the utility in particular. Gulf's evidence indicated that it was placed on 'credit watch' by four of the bond rating services as a result of the following material changes: the acquisition of Gulf Canada Limited, the purchase of Abitibi-Price, Inc., the acquisition of HWP and the Plan of Arrangement outlined herein, the plan of arrangement relating to Gulf in early 1986, the sale of Home Oil to IPL and the partial sale of FW-CW to Allied-Lyons, and the changed environment in the oil industry.

3.4 At the same time that Dominion Bond Rating Service (DBRS) placed Gulf on credit watch it also reduced the company's bond rating from AA (high) to A (low) and its commercial paper rating from R-1 (high) to R-1 (low). Canadian Bond Rating Service (CBRS) acted similarly and decreased Gulf's bond rating from A++ to A+. Standard & Poor's placed the company on credit watch but did not alter its three year old AA+ bond rating. The fourth rating service, Moody's Investors Service which has since removed Gulf from its credit watch, instituted an A2 rating

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for Gulf's bonds, a decrease from the rating for the past three years of AA3.

3.5 Mr. Dodd testified that he did not expect the downgrading to affect Gulf's future debt costs, but that it could have an effect on the company's ability to raise debt. On the other hand, he also pointed out that Gulf had raised a great deal of new debt while on credit watch.

3.6 Mr. Kierans, testified that Gulf had always been a superior credit, a rating that it continued to enjoy, albeit "somewhat diminished". He pointed out that the placing of a company on credit watch indicated an awareness by the credit agencies of certain developments within a company which had remained at the same credit rating for a long period of time. In his view, credit watch was not necessarily a matter for concern.

3.7 Mr. Kierans said that "Gulf is not financially weak, by any stretch of the imagination. ... Gulf has been and remains a superior credit." He explained that Gulf today is not the Gulf of yesterday and that Gulf is now a conglomerate and a holding company that is "in a state of metamorphosis". He emphasized that, in his view, the underlying and substantial assets of the Gulf empire together with management's stated intention of maintaining a superior

credit rating position should satisfy any concern as to the financial strength of Gulf.

3.8 Mr. Cohen testified that over the next six months it is management's intention to improve Gulf's balance sheet by decreasing the amount of debt to total capitalization from 56 per cent to about 40 to 44 per cent. He identified two options available to effect this: issuing new equity in Gulf or selling some of its corporate assets. He indicated that the cash proceeds from the HW-GW sale of approximately \$1.4 billion will be used to reduce short and long term debt.

3.9 As far as the credit rating of Consumers' parent was concerned, Mr. Kierans testified that the old parent, HWR, was probably a stronger credit than New HWR because of the HW-GW and Home Oil sale. In his opinion, New HWR is nonetheless, a "very good credit", even if the remaining interest in HW-GW was completely removed from New HWR.

3.10 Special Counsel pointed out that Gulf has become highly leveraged since it was acquired by Olympia & York in 1985. Over half of its long term debt is at floating interest rates and 25 per cent is denominated in U.S. dollars which is unhedged. He argued that Gulf's debt/equity ratio is high in comparison to other

companies engaged in similar activities and pointed out that Gulf is not only on credit watch, but that Gulf and a number of its affiliates have seen their credit ratings downgraded over the past year.

- 3.11 Mr. Kaiser also expressed concern regarding Gulf's announced withdrawal from the Beaufort Sea. Approximately \$100 million, on a pre-tax basis, of its \$500 million investment in plant and equipment associated with this project has been written off to date. His concern was that, depending on future oil prices and other events, a larger portion of this investment may need to be written off against earnings over the next few years.

The Board's Conclusions

- 3.12 In any takeover the Board must satisfy itself that the new owner is financially sound and is likely to remain so over the foreseeable future. In this case Gulf, a major Canadian corporation, has enjoyed a long history of financial success and currently has assets in excess of \$7 billion.
- 3.13 The Board has some concern regarding Gulf's significant decline in earnings in 1986 as a result of the dramatic drop in oil prices over the last year. The evidence provided in the

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September 19, 1986 HWP Information Circular showed that Gulf's earnings before income taxes and other items for the year ended December 31, 1985 were \$574 million. For the six months ended June 30, 1986, the corresponding unaudited amount was \$0 million and, according to the evidence of Mr. Dodd, is not likely to have improved by September 30, 1986. When income taxes and other items are included, the earnings from continuing operations of Gulf for 1985 and the first six months of 1986 were \$314 million and \$73 million respectively.

3.14 The Board accepts Mr. Cohen's testimony that Gulf's relatively high debt/equity ratio will be significantly improved over the next six months. Management intends to take action to lower its debt to the 40 to 44 per cent level. Further, the fact that Gulf's securities are currently on credit watch does not cause the Board undue concern as this is not uncommon in today's economic environment as it affects the oil industry.

3.15 The Board has concern regarding the decline in Gulf's earnings. However, recognizing the quality of the underlying assets of the Gulf empire, the Board concludes that Gulf is sufficiently sound financially such that the financial integrity of Consumers' should not be impaired.

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- 3.16 The Board accepts Mr. Kierans' evidence that New HWP will be financially sound. The Board is not able to assess the financial soundness of 685515 Ontario Inc. at this time. However, this matter need not in and of itself be a problem providing that the Board's recommended undertakings with respect to change of control are accepted.
- 3.17 The Board is of the opinion that the financial soundness of Consumers' proposed parents is sufficient to approve the proposed transactions provided that the Board's recommendations with respect to undertakings are accepted.

Independence of Consumers'

- 3.18 The independence of Consumers' can be partially measured by several factors including: the percentage of its shares which remain in the hands of the public (the public float); the number of directors who are considered to be independent; the separation of its auditors from those of the other companies within the corporate umbrella; the retention of the utility's head office within its franchised area; and restrictions on the change of control of the utility.

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The Public Float

- 3.19 The evidence indicated that Gulf was in favour of maintaining a public float of common shares for Consumers' because the public market is a source of equity financing; it also provides flexibility in seeking new financing and is an indicator of how well the utility is being managed in the eyes of the market.
- 3.20 Mr. Kierans testified that Consumers' 17 per cent public float "could be improved upon" but that it was adequate to permit the utility's management to determine how Consumers' was being regarded in the marketplace.
- 3.21 Mr. Cohen testified that Gulf had no intention of increasing its 82.9 per cent holding in Consumers' and that he too favoured a public float. He also indicated that although Gulf had no present plans to increase the public float or to decrease its holding, "... we think that directionally speaking, that is a sensible way to go, both for us for strategic purposes and perhaps for Consumers'."
- 3.22 Mr. Hurst submitted that Gulf should reduce its holding in Consumers' to 20 per cent. Special Counsel submitted that Consumers' and Gulf should undertake to the Lieutenant Governor in Council that neither company will permit

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Consumers' public float to fall below 15 per cent without the prior approval of the Board.

3.23 Counsel for Gulf argued against such an undertaking and pointed out that a utility was not legally required to maintain a public float and that it was not clear whether a public float was in the public interest. He submitted that the companies recognized that a public float might be to Consumers' benefit and that neither company had any intention of decreasing it but that "Circumstances may change ... to make it desirable from all points of view ..." that it be decreased.

3.24 Gulf therefore proposed an undertaking which would require that ten business days prior written notice be given to the Board by Gulf or New HWR or 685515 Ontario Inc. of any intention to take any action which would reduce the public float of Consumers' below ten per cent, save when any of them is required to inject equity.

The Board's Conclusions

3.25 Gulf was unwilling to "... irrevocably commit to an undertaking which would require the public float to be maintained or increased.", yet it has specified three reasons which support the existence of a public float of

common shares of a utility and has indicated that it sees merit in increasing the level of Consumers' public voting stock. The Board agrees that the benefits of a public float as set out by Gulf are valuable, but is concerned that Gulf's proposal might not be adequate to realize these benefits.

3.26 If Gulf were only to advise the Board within ten business days of any action that would result in a public float of less than ten per cent, it would be difficult for the Board to be assured that any resulting minimal public float would provide the Board with reliable market data or would facilitate access to the market for additional common equity to finance capital expansion.

3.27 The Board is of the view that it is healthy to have enough public or independent shareholders with interests that may differ from the majority shareholder to achieve the above-noted benefits and also to assist in assuring the Board of Consumers' independence from the interests of the controlling parent and grandparent. It is difficult, however, to set a level which will be appropriate over time and in all circumstances. In the past the Board, although favouring a public float of common shares, has been reluctant to force one. In this case, Consumers' already has a 17 per cent public

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float which, if reduced, could cause the Board some concern.

- 3.28 In view of Gulf's evidence that it does not plan to decrease the float and in fact may increase it, Special Counsel's 15 per cent level should not create difficulties for Gulf and would allow Gulf a small range of flexibility if circumstances should change before coming back to the Board for approval. Accordingly, the Board recommends that the signatories to the undertakings should undertake that none of them will take any action to reduce Consumers' public float of common shares below 15 per cent without the prior approval of the Board.

Consumers' Board of Directors

- 3.29 Insofar as the question of independent directors was concerned, all parties agreed that the Board should recommend to the Lieutenant Governor in Council that its approval contain provision for the retention of a majority of independent directors on Consumer's Board. However, there was no agreement as to the meaning of 'independent'.

- 3.30 Gulf, defined an independent director as one who was not an employee, officer or director of Gulf or any of its associates other than

Consumers' and its associates and who was representative of the communities served. Special Counsel, on the other hand did not consider an employee or officer of Consumers' or an employee, officer or director of any of its affiliates or associates to be independent.

3.31 Special Counsel submitted that Gulf's definition of independent was too narrow and suggested that there were several techniques that could be used to ensure independence of directors. These include giving the public shareholders the right to vote the majority of the Board of Directors or having a shareholders' agreement whereby shares would be deposited with and voted by a Depositary towards the election of independent directors nominated by an independent Director Selection Committee. Special Counsel argued that there were drawbacks to using these procedures in this case and that the proposal of his witness, Mr. Ghert, was preferable, as it was the only one to specify on definite terms who is an independent director.

3.32 Mr. Ghert testified that it was necessary to go beyond Gulf's definition and also to prohibit a director from having substantial business dealings with Consumers' or any of its affiliates. Special Counsel urged the Board to accept Mr. Ghert's evidence that directors should not be

'insiders' of or engaged in 'related party transactions' with or be 'economically dependent' on Gulf or any of its affiliates.

3.33 Mr. Ghert adopted the definition of the term 'insider' from Sections 121 and 125 of the Canada Business Corporations Act. That Act provides, inter alia, that an insider is a person who owns or controls more than ten per cent of the shares of the corporation; an employee, director, officer or person retained by the corporation; the corporation itself or one of its affiliates; and a person who receives confidential information from any of the above. A similar definition can be found in the Securities Act (Ontario).

3.34 For the remaining two definitions, Mr. Ghert looked to the Canadian Institute of Chartered Accountants (CICA) which, in Section 3840 of its Handbook, defines a "related party transaction" as one where a party has the ability to exercise control or significant influence over the operating and financial decisions of the other party to the transaction. "Economic dependence" is defined in the same section of the Handbook as occurring when an entity conducts a significant volume of business with the company as a lender, borrower, customer, supplier or distributor, and so on.

- 3.35 Special Counsel pointed out that the auditors of a public corporation are currently required to determine and disclose which directors are in a position of economic dependence with respect to the corporation or engaged in related party transactions. He therefore submitted that Consumers' should require its auditors to conduct an annual review and to advise the Board as to whether a director was found to be in a related party or economic dependence situation.
- 3.36 Mr. Sharpe took no specific objection to Mr. Ghert's evidence and recognized that there are many ways to define independent. He argued, however, that Gulf's proposed definition was appropriate and provided sufficient protection to keep Consumers' Board independent from its parent and Gulf.
- 3.37 Amendments to the Ontario Energy Board Act contained in Bill 142, tabled in the Legislature on October 23, 1986, stipulate that the majority of a utility's directors shall not be employees, officers or directors of an associate of the utility.

The Board's Conclusions

- 3.38 Gulf has proposed an undertaking similar to the HWP undertaking of 1981 regarding the Board of

Directors, but has added a definition of an independent director as one who is not an employee, officer or director of Gulf or any of its associates other than Consumers' and its associates. Although this might be an adequate definition in most instances, there was much discussion in this case as to whether, over time, there could in fact be such a thing as an independent director where one party controls 82 per cent of the voting stock. As Mr. Hurst pointed out:

This is not to suggest that actions may be taken to favour the owner, but rather that actions are not likely to be taken and statements not likely to be made when these would go against the wishes of the majority owner.

- 3.39 The Board agrees that the independence of Consumers' Board of Directors is of the utmost importance. It notes that in the October 31, 1983 Shareholders' Agreement between, inter alia, Imperial Oil Limited and HWR respecting the selection of independent directors of IPL, an independent director was described as a person who "... is governed or can reasonably be expected to be governed" in the exercise of his duties "... solely by considerations relating to the best interest of IPL and without specific regard for the interests of [the shareholders] HWR or Imperial, other than as two shareholders out of the general body of

shareholders of IPL". The Board believes that the definition of 'independent' should strive to achieve this objective. The Board wishes to provide for a truly independent Board of Directors for Consumers'. It believes it can achieve this by providing for both independence from management and economic independence of a majority of the members of the Board of Directors.

- 3.40 A number of methods used to ensure that independent directors are in fact independent were canvassed in argument. In the Board's opinion, the definition of 'independent' proposed by Special Counsel, as modified, best achieves the objective of a person being governed solely by considerations relating to the best interest of Consumers' without specific regard for the interests of Gulf or its associates. Special Counsel's proposal to adopt the definition of "insider" to ensure independence was, in the Board's opinion, too broad. The Board, however, recognizes that certain aspects of the definition are appropriate in the consideration of independence, namely, to preclude persons retained by Consumers' or persons with more than a 10 per cent ownership interest in Consumers'.

- 3.41 The Board, therefore, recommends an undertaking which requires that the majority of the Board

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of Directors of Consumers' be, at all times, independent of Gulf, Consumers' and their affiliates or associates.

3.42 An independent director shall exclude the following persons:

- o employees or officers of Consumers' or persons retained by Consumers';
- o employees, officers and directors of those companies affiliated or associated with Consumers';
- o persons in positions of "economic dependence", within the definition provided by the CICA;
- o persons who are "related parties", within the definition provided by the CICA; and
- o persons who own or control, directly or indirectly, more than 10 per cent of the shares of Consumers'.

3.43 The Board recommends that Consumers' be required to cause its auditors to file with the Board at the time of the appointment of a new director and on an annual basis, a report indicating any related party transactions of Consumers' directors or situations of economic dependence

and confirming that the majority of the Board of Directors is independent within the meaning of the previously described undertaking.

The Auditors

3.44 The evidence indicated that Consumers' does not presently employ the same external auditors as any of the other companies under the control of Olympia & York. Special Counsel submitted that since his proposal with regard to ensuring the independence of Consumers' Board of Directors placed a minor regulatory burden on its auditors, Gulf and New FWR should undertake that the auditors retained by Consumers' be an accounting firm that is not engaged in auditing the accounts of Gulf or its affiliates.

3.45 Mr. Sharpe argued that this was not necessary as auditors are independent and "... are expected to act in a manner consistent with their professional obligations".

The Board's Conclusions

3.46 The Board recognizes Mr. Sharpe's concern regarding any implication that qualified, professional, external auditors would conduct themselves in a manner other than as professional independent auditors. The Board is aware of subsections 151(1) and (2) of the

Ontario Business Corporations Act, 1982 which deal with the disqualification of auditors who are not independent of the corporation, all of its affiliates, or of the directors or officers of the corporation and its affiliates. Certain criteria for determining independence are also outlined in these subsections.

3.47 The Board does not question the independence or professionalism of any of the external auditors currently retained or to be retained by Gulf, its affiliates or Consumers'. However, in the opinion of the Board, the independence of Consumers' is of such importance that there should be no perception that the appointment of Consumers' auditors is, or could be, in any way influenced by the change in ownership of the utility's voting shares.

3.48 Since Consumers' auditors are already different from those of Gulf and its affiliates, and the Board has recommended an expanded role for the auditors in monitoring the independence of Consumers' Board of Directors, the Board recommends that an appropriate undertaking should be that the auditors retained by Consumers' continue to be different than those retained by Gulf, New HWR or 685515 Ontario Inc.

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Head Office

- 3.49 Both Counsel for Gulf and Special Counsel agreed that an undertaking similar in form to that given by utilities in prior approval situations should be given whereby Consumers' will not remove its head office from its franchise area.

The Board's Conclusions

- 3.50 The Board accepts as reasonable Special Counsel's proposed undertaking, as agreed to by Gulf, that requires the head office of Consumers' to remain in the utility's franchise area.

Change of Control

- 3.51 One of the central issues in the Union/Unicorp Report was the failure of the present legislation to require approval when change of control of a utility is effected indirectly through the acquisition of the shares of another company rather than through the shares of the utility itself. As Special Counsel pointed out in his argument, the present approval section was drafted in simpler times. In the Union/Unicorp Report, the Board recommended that the

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legislation be updated to require the pre-approval of takeovers of a utility's parent or grandparent.

3.52 Special Counsel argued that Consumers', Gulf, New HWR and 685515 Ontario Inc. should all give an undertaking to the effect that none would take any action which would result in any person acquiring control of more than 20 per cent of the voting shares of Consumers', either directly or indirectly, without the leave of the Lieutenant Governor in Council. He submitted that the Board should approve the subsequent sale of Consumers' from New HWR to 685515 Ontario Inc. only if 685515 Ontario Inc. becomes a party to this and other undertakings and if it is a wholly-owned subsidiary of New HWR.

3.53 Mr. Cohen testified that Gulf had been approached by persons wishing to purchase Consumers' but that there were no present plans to sell the utility or its holding company/parent.

3.54 Mr. Sharpe argued that Gulf's suggested undertaking in regard to change of control was sufficient. He submitted that the government's view of the public interest, insofar as the regulation of utilities was concerned, has not yet been "crystallized and enunciated". As a result, Gulf proposed a notification mechanism

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to permit the government to consider the problem should it arise and determine then whether "... existing public policy requires legislative or executive intervention".

3.55 Gulf's proposed undertaking concerning this matter provided for:

- o ten days prior notice to the Minister of Energy and the Board of any intended change of control of either 685515 Ontario Inc. or New HWR; and
- o notice to the Minister of Energy and the Board, forthwith, insofar as there is any knowledge of a potential change in control of a company which holds Consumers' common shares as its principal asset (i.e. more than two-thirds of the aggregate fair market value of its total assets).

3.56 Special Counsel criticized this submission because it only dealt with a change of control within the knowledge of the signatories and only required the companies to inform of a potential change of control, not await the government's approval. As well, he pointed out that under Gulf's definition of principal asset effectively only 685515 Ontario Inc. would be required to give notice of a sale of its shares. That too, he submitted, could be

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avoided if any additional assets were included under that company's ownership so that its Consumers' shares would form less than two-thirds of its total assets.

3.57 In reply, Mr. Sharpe argued that there was no need to provide an undertaking that 685515 Ontario Inc. remain wholly-owned since its status was covered by the Applicant's proposed undertaking with respect to change of control to which that company would be a signatory.

3.58 Mr. Hurst recommended that no person should be permitted to own more than 20 per cent of the common shares of a utility, regardless of the undertakings. He expressed concern that Gulf's proposal would facilitate a subsequent indirect transfer of ownership of Consumers' without a review comparable to this proceeding.

3.59 Bill 142 extends the present approval process under the Act in two particular areas:

- o it provides specific criteria for the review of applications for changes in utility ownership; and
- o it provides for the attachment of terms and conditions to the approval.

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- 3.60 The Bill is designed to ensure that the public interest with respect to natural gas prices, service and reliability is protected, regardless of who owns or controls the utility.

The Board's Conclusions

- 3.61 Gulf explained to the Board its reason for creating New HWR. Without the interposition of New HWR between Gulf and HWR the debt obligations of HWR and WHO would be assumed directly by Gulf upon the dissolution of the two companies. Because the covenant patterns in the various debt obligations of HWR and WHO differ significantly from those of Gulf and there are certain restrictive covenants in some of the HWR debt instruments that are incompatible with the carrying on of a oil and gas exploration business, the Applicant wishes to segregate those debt obligations from those of Gulf.
- 3.62 With regard to the creation of 685515 Ontario Inc., Mr. Cohen testified that Gulf would like to be in a position of maximum flexibility from a business point of view and that possible pending changes in the tax system might make it more difficult to reorganize at a later date.
- 3.63 The Board understands these explanations, but also recognizes that the resulting effect of

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these changes is a corporate structure which will permit Gulf or New HWR to indirectly transfer the control of Consumers' without coming back to the Board for a recommendation of approval. Some of the participants in this proceeding expressed concern that the reorganization the Board is being asked to approve will allow such a subsequent change in control. For example, Gulf, having caused Consumers' to be 82.9 per cent owned by 685515 Ontario Inc., could then arrange for its sale and circumvent the existing legislation. As previously noted, the financial soundness of 685515 Ontario Inc. cannot be assessed at this time. The Board reiterates its opinion, as expressed in the Union/Unicorp Report, that any legislative change should require express approval of change of control of a gas utility's parent or grandparent. Instead, the proposed legislation (Bill 142) has adopted a "picket fence" approach with a number of "rules of conduct" to protect the public interest regardless of who owns or controls the utility.

- 3.64 In this case, where the resulting corporate structure will put the change of control of Consumers' so readily beyond the Board's and the government's purview and where interest in acquiring Consumers' has already been expressed, the Board is concerned that without knowing the

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identity of a subsequent owner and other conditions, it is difficult to anticipate and provide for all circumstances and the full impact resulting from the change of control of Consumers'. The government needs to be assured that there will be no untoward effect on the performance of the utility in regard to its legal obligations to or its social contract with its customers and other members of the community.

3.65 The Board agrees with Special Counsel that the provision of ten business days written notice is likely insufficient to allow the government time to deal with the matter in a meaningful sense; that in some cases the shareholder may not have knowledge of changes in control; and that the 'principal asset' criterion could be circumvented by the purchase of additional assets.

3.66 The Board is also concerned that Gulf's proposal would only apply to a change of control which it considers as occurring when the purchaser acquires the right to elect a majority of the board of directors. The present section 26 of the Act refers to a change in control of twenty per cent of the shares of a utility, whether or not this entails the right to elect a majority of the board of directors, and the Board has been

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offered no rationale as to why this should be changed.

3.67 The Board, however, recognizes Gulf's concern with Special Counsel's proposed undertaking which could be triggered by a change of control of Gulf or other companies further up the chain of the Reichmann businesses. The Board does not believe that the leave of the Lieutenant Governor in Council should necessarily be required in such instances, since the interference with private commercial transactions at some level begins to outweigh the benefits of the review process. The Board has, however, already expressed its concern about the effect of a change in control of New HWR or 685515 Ontario Inc.

3.68 Accordingly, in view of the circumstances in this case, the Board is recommending an undertaking to the effect that none of the signatories shall take any action, without first obtaining leave of the Lieutenant Governor in Council, that will result in any person acquiring:

- a) more than twenty per cent of the voting shares of Consumers'; or
- b) control of any person that owns or controls such voting shares of Consumers' where

such shares constitute a significant asset of such person.

The Board will adjust Gulf's definition of 'principal asset' to define 'significant asset'. Thus, the voting shares of Consumers' shall constitute a 'significant asset' of a person where the fair market value of the voting shares of Consumers' beneficially owned, directly or indirectly, constitutes twenty per cent or more of the aggregate book value of the total assets of such person determined on a consolidated basis in accordance with generally accepted accounting principles.

3.69 The Board recommends that the undertaking indicate that application for leave be made to the Board which will hold a public hearing and submit its opinion and report to the Lieutenant Governor in Council.

3.70 The Board agrees with both Special Counsel and Gulf that 685515 Ontario Inc. should be a signatory to the undertakings but does not believe that it is necessary for it to be a wholly-owned subsidiary of New HWR for the Board to recommend the approval of the transfer of Consumers' from New HWR to it, in view of the undertakings that the Board is recommending with respect to change of control.

Affiliated Transactions

- 3.71 For the purpose of this Report, an affiliated transaction is defined as a sale of goods, services or information or the conferring of a benefit, between a regulated utility and any associate of the utility. The Board's concern is that such a transaction has the potential for unfair pricing which may ultimately prejudice the utility's customers. A utility's gas purchases from an associated company is the most obvious area of potential abuse but this section also considers gas sales by Consumers' to an associated company as well as other affiliated transactions.

Gas Purchases

- 3.72 The evidence indicated that Gulf has about 50 MMCFD ($1416 \times 10^3 \text{ m}^3/\text{day}$) of uncommitted gas supplies which could be made available to Consumers'. However, Gulf's witnesses stated that there were no plans for the companies to enter into any supply arrangements and, in any event, Consumers' already had its 1987 volumes committed from TCPL. Gulf itself presently sells a total of about 336 MMCFD ($9518 \times 10^3 \text{ m}^3/\text{day}$) to TCPL and other pipelines in western Canada.

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- 3.73 Special Counsel called Dr. Irwin to testify concerning this issue. Dr. Irwin gave evidence that he had undertaken an extensive study of affiliated transactions in connection with the court ordered breakup of American Telephone and Telegraph in the United States. He testified that the only solutions were complete prohibition of such transactions by the regulatory board or divestiture of the regulated utility from the remainder of the corporate structure.
- 3.74 Dr. Irwin said that the attempt to test the fairness of an affiliated transaction in the telecommunications industry was "very expensive and very elusive". He pointed out that, in the natural gas industry, differing volumes and contract terms involved in such a comparison would also make the task very difficult.
- 3.75 Special Counsel pointed out that there were insufficient publicly known transactions available to derive a reliable industry benchmark for gas purchases. He therefore recommended that an undertaking be given whereby Consumers' be prohibited from purchasing gas from Gulf or any of its affiliates.
- 3.76 Mr. Sharpe pointed out that to prohibit gas purchases from Gulf would lessen Consumers' competitive choice and would be against the public interest. As well, he argued that the

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utility's independent Board of Directors would provide "... an adequate safeguard against the type of situation with which the Board has expressed concern."

3.77 The Applicant argued that there was no evidence that it has or will in the near future be in a position to supply substantial quantities of natural gas to Consumers'. In reply argument Mr. Sharpe stated "... there is no reason to believe that Gulf can supply any material amount of Consumers' requirements for at least the next decade."

3.78 Mr. Hurst testified that in his opinion, "it would take a secure Consumers' management to not purchase natural gas" from one of Gulf's companies and that therefore Consumers' ability to seek gas supplies from all potential sources was thereby abridged.

Other Transactions

3.79 Mr. Kaiser argued that other material inter-affiliate transactions be allowed only where the prior approval of the Board has been obtained. He did not raise any objection to gas sales by Consumers' to an associate because such transactions are captured by the normal regulatory process. However, he argued that all affiliated transactions in excess of

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\$10,000 be reported by Consumers' annually to the Energy Returns Officer.

3.80 Insofar as inter-corporate management fees were concerned, he pointed out that the evidence indicated that such fees, (presently about \$250,000 per year to cover Consumers' lack of an internal treasury), may be largely discontinued if the utility develops its own treasury department.

3.81 Mr. Sharpe pointed out that there clearly are areas of commercial operation in which economies of scale are achieved by corporate collaboration; he identified the areas of insurance and pension benefit administration. However, it was Mr. Sharpe's position that the Applicant's proposed undertaking "... that any such transaction which is material would require approval by a majority of the independent directors of Consumers' will ensure that the best interests of Consumers' and its various constituencies (not only shareholders, but customers as well) are protected".

The Board's Conclusions

3.82 The Board recognizes that prudent management may well arrange transactions among affiliated entities of a conglomerate which can be beneficial to the customers of the utility. On the

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other hand, the Board realizes that business opportunities exist for a parent corporation to so arrange its affairs that inter-company transactions could lead to advantages to the parent and disadvantages to the subsidiary utility and its customers. As long as those opportunities exist it is the Board's view that some form of protection of the utility is required.

- 3.83 This issue was extensively reviewed in the Union/Unicorp Report, and the Board concluded that "... affiliated transactions should require the prior approval of the Board". The objective was that this Board be informed in advance and that it could approve any affiliated transaction without a hearing.
- 3.84 The Board concludes that the sale and transportation of natural gas by Consumers' to Gulf or any of its affiliates need not be the subject of an undertaking as such transactions are regulated by the Board in its normal ratemaking process.
- 3.85 The Board has concluded that the prohibition solution as proposed by Dr. Irwin may be unfair to Gulf and Consumers' in the present environment where alternate or additional sources of gas supply are, through public policy, being encouraged and promoted. Accordingly, the

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Board concludes that it would be inappropriate to prohibit such affiliated transactions, but will require prior approval of material gas purchases.

3.86 The Board continues to hold the view that it must be informed in advance of material affiliated transactions but recognizes the need to avoid administrative reporting problems for both the companies and the Board associated with routine and relatively inconsequential transactions.

3.87 Therefore, the Board recommends that there be an undertaking to provide as follows:

Any affiliated transactions, other than the sale and transportation of gas by Consumers', aggregating \$100,000 or more annually relating to the supply of goods, services and information, including gas purchases, between Gulf and its affiliates or associates and Consumers' shall require prior approval of the Board.

Financial Integrity of Consumers'

3.88 The maintenance of Consumers' financial integrity is important to its customers as well as to its shareholders. In fact, it is so important that the Board's statutory duty to

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set just and reasonable rates includes a provision for a return on equity which ensures the financial health of the utility. The continued stability of a utility following a change of ownership is nothing more than an extension of this function.

- 3.89 This measure of financial health is approximated by examining the company's current dividend policy, debt/equity ratio, capital structure, financing plans and returns on rate base and equity. The evidence in this hearing did not indicate any material change in these factors from the time of the Board's last examination in E.B.R.O. 414 and thus the Board is satisfied that Consumers' continues to be financially sound. This section will deal with the proposed undertakings which are designed to maintain that strength and with certain changes to the support arrangements for pre-1981 debt holders.

Support Arrangements

- 3.90 Mr. Kierans testified that Consumers' is a financially strong company and that Gulf's proposed undertakings ensure that the utility will be able to finance itself on a stand alone basis. To support this he pointed out that post-1981 bondholders have not required any external support for Consumers' bonds and the

utility's credit rating had increased during that time from B++ to A.

- 3.91 Special Counsel submitted that Consumers' future creditors should not require any external support arrangements for their debt and that the replacement of the current guarantees for the pre-1981 bondholders and preferred shareholders with either a bank guarantee or a guarantee of New HWR, was sufficient to maintain the level of security accorded to the bondholders, debtholders and preferred shareholders. However, he proposed an undertaking that any existing support arrangements shall not be altered without the prior approval of the Board.

- 3.92 Mr. Sharpe argued in reply that changes in the support arrangements should be governed by the terms of those arrangements themselves which are those that have been in place since 1981.

The Board's Conclusions

- 3.93 The Board concludes that the replacement of the current guarantees for the pre-1981 bondholders and preferred shareholders with either a bank guarantee or a guarantee of New HWR is sufficient to maintain the level of security accorded to Consumers' bondholders, debtholders and preferred shareholders. The Board recommends that there should be an undertaking that any

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support arrangements existing after the reorganization whereby Gulf or its affiliates have guaranteed or supported the bonds, debentures, loans or preference shares of Consumers' shall not be altered without the prior approval of the Board.

Maintenance of Common Equity

3.94 Mr. Cohen testified that as Consumers' was now able to enter the capital markets itself, it was not necessary for Gulf to provide an undertaking whereby it would provide additional equity capital if necessary. However, Gulf agreed that it was bound by the HWR undertaking given at the time of its reorganization in 1981 whereby HWR was not to allow Consumers' equity level to fall below that approved by the Board. That undertaking was conditional, however, upon HWR being assured that any such injected equity would earn a reasonable rate of return.

3.95 The 1981 undertaking of HWR in regard to this issue stated that HWR would:

cause to be retained in (Consumers') such portion of the earnings of (Consumers') as may be appropriate from time to time for retention by a gas distribution utility, and to the extent that, at any time, such retained earnings are not sufficient to maintain the equity of (Consumers') at a level appropriate for a gas

distribution utility company to provide, within a reasonable length of time, additional equity capital sufficient for that purpose, either directly or from other sources, including the issue of shares to the public, provided that a reasonable rate of return on equity capital be allowed. For the purposes of this undertaking, HWR shall be bound by a determination of the Ontario Energy Board (the "Board") of an appropriate level of equity capital up to the level which the Board found to be appropriate for the purposes of (Consumers') rate hearing held in the fall of 1980, as set forth in the Board's reasons for decision dated January 30, 1981.

3.96 Mr. Sharpe argued that rather than an undertaking from Gulf to provide such equity, Consumers' Board of Directors was best able to deal with the question of the utility's financial integrity including its future financing, changes in its capital structure and the maintenance of its common equity ratios. This, he pointed out, was consistent with the Board's objective of maintaining a stand alone utility.

3.97 He submitted that in previous approval applications dealing with changes in ownership of Ontario's two other major utilities, an undertaking was required from the parent because there was no public float in those utilities. In such a case, he argued, there was no

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alternative to the parent providing the necessary capital if the utility was to remain privately owned.

3.98 Special Counsel advocated that the Board recommend the continuance of the 1981 type of undertaking, which included the maintenance of an appropriate level of retained earnings as well as provision for the injection of any necessary equity, but that it be amended by removing the condition of achieving a reasonable rate of return.

3.99 He argued that Gulf could, in order to prevent dilution of its interest, restrain the utility from entering the equity markets or Consumers' might not be able to enter the market on favourable terms. Either occurrence, he argued, required that the present undertaking, without the condition, be continued.

The Board's Conclusions

3.100 The Applicant has taken the position that Consumers' is a healthy company with a strong credit rating and that it has a proven ability to access the public markets for both debt and equity capital. It concludes that, in the absence of any adverse effects flowing from the recent change of control, there is no reason to believe that Consumers' financial health or

financial integrity will deteriorate. Mr. Sharpe, in argument, goes on to say that Consumers' financial integrity and the manner in which it deals with issues relating thereto, such as maintenance of common equity, future financing and changes in capital structure, are matters for its own internal Board of Directors and management.

- 3.101 In April 1981, HWR undertook to provide assurances that Consumers' level of common equity would not fall below the 33.3 per cent level approved by the Board in its Reasons for Decision dated January 30, 1981. The Board's concern is that the financial integrity of the utility be maintained so that its ability to serve its customers is not jeopardized in any way by the actions of the new parent. Gulf has taken the position that these matters can be controlled through the Board's rate hearing process and that Gulf should not be faced with this continuing obligation. Mr. Cohen took the position that Consumers' is no longer a wholly-owned subsidiary and has access to the capital markets. Mr. Kaiser pointed out the possibility that Gulf may not permit Consumers' to go to the capital markets as Gulf's ownership interest may thereby be diluted. The other possibility is that Consumers' may not be able to go to the capital markets and raise capital on favourable terms.

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3.102 Gulf's proposed undertaking in this regard is also conditional on a reasonable rate of return on equity capital being obtained. In the Board's view such an undertaking is meaningless for two reasons:

- o It relies on Gulf's interpretation rather than a Board Decision as to what is reasonable; and
- o The Board sets rates to permit an allowed rate of return to be earned by Consumers'. The Board, in other words, does not guarantee a rate of return. If Consumers', for various reasons, is unable to earn or obtain that allowed rate of return then presumably the undertaking as proposed by Gulf would have no meaning.

3.103 While it is reasonable for Gulf to expect a reasonable rate of return on equity if it is expected to inject equity capital, the Board's statutory mandate is to offer the utility an opportunity to earn a reasonable rate of return. In deciding on what is reasonable the Board must and does consider the reasonableness to customers, shareholders and debtholders. Accordingly, the Board will not recommend such a condition in this undertaking.

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- 3.104 Section 37f of Bill 142 provides that the Board's approval is required before a utility pays a dividend or takes other action which will result in the common equity component of a gas utility's capital structure falling and remaining for a period of ninety days below the level approved or considered appropriate by the Board's most recent applicable decision.
- 3.105 The Board shares the Government's concerns in this regard and concludes that one of the many responsibilities of a parent company is to ensure that its subsidiaries have adequate equity at all times. This is particularly important in the case of a subsidiary which is a public utility. Accordingly, the Board concurs with Mr. Kaiser and recommends that there be an undertaking the same as Special Counsel's undertaking to ensure that the common equity of Consumers' is maintained at a level found appropriate by the Board in its rate decisions from time to time.
- 3.106 The Board further recommends that Consumers' shall raise or Gulf and/or its affiliates shall undertake to provide to Consumers', either directly or indirectly, within 90 days of an insufficiency of equity being identified, sufficient additional equity capital, provided that if Gulf and/or its affiliates supply such additional capital it shall be on terms no less

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favourable to Consumers' as those Consumers' could obtain directly in the capital markets.

Inter-corporate Indebtedness, Guarantees and Investments

3.107 Previous approvals under Section 26 of the Act have included some form of provision whereby the utility concerned was prevented from securing the indebtedness of other companies within its corporate umbrella. In this case, Counsel for Gulf and Mr. Cohen both agreed that Consumers' should not loan funds to, guarantee the obligations of, or invest in, Gulf or any of its affiliates except subsidiaries of Consumers' itself without the prior consent of the Board.

3.108 Special Counsel went further and advocated that the prohibition should extend to subsidiaries of Consumers' which are not regulated under the Act and to persons which, besides other corporations, could also include Consumers' officers and employees.

The Board's Conclusions

3.109 The 1981 undertaking from HWR in regard to this issue stated that it would "... not permit or direct (Consumers') to borrow for or guarantee

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the obligations of HWR or other subsidiaries of HWR."

3.110 The Board continues to consider it important that Consumers', the utility, be fully protected with respect to its future indebtedness, guarantees and investments.

3.111 In this regard, the Board is aware that Section 37f of Bill 142 provides that a gas utility shall not, without the prior approval of the Board:

- (a) advance funds or otherwise confer a benefit to or to the order of or for the benefit of an associate;
- (b) acquire or pay for securities of or held by an associate;
- (c) become responsible for the indebtedness or obligations of any person; or ...

Accordingly, the Board concludes that the following undertakings, as proposed by Special Counsel, are essential:

Consumers' will not loan or advance funds to or guarantee or become responsible for the indebtedness or obligations of any firm, person, associate, affiliate or subsidiary of Consumers' that is not regulated under the Ontario Energy Board Act

without the prior approval of the Ontario Energy Board.

Consumers' will not acquire or pay for securities of any person, firm or affiliate, associate or subsidiary of Consumers' that is not regulated under the Ontario Energy Board Act, without the prior approval of the Ontario Energy Board.

Regulatory Issues

- 3.112 Regulatory issues include the treatment to be accorded golden parachute arrangements, the acquisition and reorganization costs, and non-utility investments (diversification).

Golden Parachutes

- 3.113 Gulf's evidence indicated that Mr. Martin, President of Consumers', entered into an employment contract with Consumers' dated March 25, 1986 pursuant to which he is entitled to receive three years' salary and certain other benefits if he resigns or has his employment terminated within two years after certain "triggering events". Alternatively, if Mr. Martin remains in Consumers' employ for the two year period following a "triggering event", he will be entitled to receive a bonus equal to one year's salary. One of the triggering events is a change in effective control of Consumers' following the date of the contract.

Gulf announced its takeover intentions on March 19, 1986, but did not acquire its control of HWR until April 23, 1986.

- 3.114 When answering an interrogatory regarding this subject, Gulf stated that:

... to the extent that any payment is made by Consumers' to a Consumers' senior officer and that payment is considered to be a reasonable business expense of the utility, Gulf understands that Consumers' will request that such payment be included in cost of service; and to the extent that such incentive and termination contracts are normal business arrangements and constitute a reasonable cost to the utility, Gulf understands that Consumers' would consider them to be a normal cost of service and would request recovery in rates of such costs.

- 3.115 Mr. Dodd, however, conceded that "golden parachutes" may be looked upon as an indirect cost of acquisition and therefore might become a regulatory concern.

The Board's Conclusions

- 3.116 As a result of the current reorganization, the incremental costs of this contract over Mr. Martin's previous contract might be requested in Consumers' cost of service in due course. While the amounts involved may be relatively

insignificant in relation to Consumers' total cost of service, they represent costs which would not be incurred were it not for the fact the change in control of Consumers' has taken place.

- 3.117 The Board is of the opinion that this golden parachute and any others that may exist are in effect acquisition costs, which should not find their way into the utility's cost of service and rates. The Board therefore recommends that the costs of any golden parachutes be included in the recommended undertaking with regard to acquisition and reorganization costs.

Acquisition and Reorganization Costs

- 3.118 Gulf's proposed undertaking indicates that Consumers' will not include in its rate base or recover in its cost of service any of the acquisition or reorganization costs incurred by any of the signatories to the undertakings in connection with the acquisition of shares of HWR or of shares of Consumers' by any of the signatories.
- 3.119 Special Counsel proposed a similar undertaking and submitted that this undertaking and Mr. Cohen's evidence in the same regard would mean that the shareholders will bear any expenses associated with the acquisition and that this

should alleviate any concern that the proposed transaction might increase either the cost of service or the rate base.

The Board's Conclusions

- 3.120 Except for the omission of reference to golden parachutes, the Board is satisfied that the proposed undertakings should ensure that Consumers' customers will not bear any costs as a result of this acquisition and reorganization. The Board, therefore, recommends that Special Counsel's proposed undertaking be amended as follows:

Consumers' will not include in its rate base or recover in its cost of service any of the acquisition or reorganization costs, including golden parachutes, incurred by the signatories in connection with the acquisition of shares of HWR or of shares of Consumers' by Gulf, New HWR or 685515 Ontario Inc.

Diversification

- 3.121 Consumers' presently has numerous subsidiaries not regulated by this Board.
- 3.122 Special Counsel argued that unlimited investment in non-utility activities could jeopardize the

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utility's ability to meet its customers needs and was not consistent with its franchised monopoly. In addition to creating a threat to the ability to serve and to the financial integrity of the utility, he submitted that such investments can impose a substantial regulatory burden on the Board, especially if the non-utility investment is held directly within the utility.

- 3.123 He recommended that Consumers' give an undertaking not to invest or participate in any activity that is not subject to the regulation of the Board without the prior approval of the Board, but he did not advocate that the utility divest itself of its present subsidiaries.
- 3.124 Gulf disagreed with the proposed undertaking and submitted that Consumers' internal operations should not be regulated by undertakings given by its major shareholders, but rather through the normal regulatory framework or the legislature itself.
- 3.125 Bill 142 outlines the intent of the Government to implement rules governing utility diversification. The Bill is designed to insulate utilities from the risks of non-utility activities and will require non-utility investments after April 9, 1986 to be carried out in separate, non-subsiary corporations. A

utility is thus prohibited in the future from engaging in or investing in non-utility businesses without the approval of the Board. The Bill provides that such approval may have terms and conditions attached to it.

The Board's Conclusions

- 3.126 The Board shares the Government's concern that gas utilities ought to be insulated from the risks associated with non-utility activities. To the extent that Special Counsel's proposed undertaking is consistent with the provisions of Bill 142 which address the question of diversification, the Board recommends that it be accepted.
- 3.127 However, subsection 37e(3) of Bill 142 provides for a two-year period for a utility to either divest itself of a prohibited business or investment or obtain the approval of the Board to its continuance, if such business was entered into between April 9, 1986 and the day upon which the Bill receives Royal Assent. The Board concurs with this provision of the proposed legislation and recommends that Special Counsel's proposed undertaking in this regard be amended accordingly.

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4. THE PUBLIC INTEREST AND UNDERTAKINGS

The Public Interest

- 4.1 As outlined in Chapter One, the Board discussed the public interest in terms of those issues addressed in Chapter Three. This Chapter brings together the Board's conclusions in that regard in order to evaluate the effect of the transaction on the public interest. To assist the Board in this exercise, each counsel made submissions on the definition and the overall effect of the transaction on the public interest.
- 4.2 Mr. Sharpe argued that the test of the public interest was whether or not the transaction would "... result in Consumers' being unable to meet its obligations -- to its shareholders and debtholders, its customers and the public generally -- in an efficient, economical and reliable manner".

REPORT OF THE BOARD

- 4.3 He argued that the Board should weigh the advantages and disadvantages of the transaction and that "... if the balance is even or if the advantages outweigh the detrimental effects, the transaction should be allowed to proceed." He argued that "... any other view of the Board's function would amount to an unnecessary and unwarranted interference in an open economic system."
- 4.4 He submitted that there was no evidence that debtholders, customers or any portion of the public would be disadvantaged as a result of the transfer of Consumers' shares.
- 4.5 Special Counsel submitted that the public interest:
- ... covers virtually any issue which, in the tribunal's discretion, impacts upon shareholders, customers or competitors. At the heart of all of the issues is the future financial viability of the regulated company and any particular regulatory difficulties which may arise from the transaction.
- 4.6 He argued that the Application should not be approved unless Special Counsel's proposed undertakings were included in the Order in Council approving the Application.

The Board's Conclusions

4.7 As a result of recent changes in the ownership of Ontario's two other major gas distributors, the Board has developed an understanding of the public interest components involved in the acquisition of a public utility. The extensive research on this issue, both in this country and in the United States, has been closely examined by the Board in the past and utilized in the Inter-City Gas Corporation and the Union/Unicorp Reports referred to earlier.

4.8 In those Reports, the Board said that the public interest was not generally definable without knowing the particular set of facts to which it was to be applied. In the Inter-City Gas Corporation Report, the Board said:

The public interest will consistently take the form of the facts to which it is applied, moulding itself to the specific use to which it is being put.

In the Union/Unicorp Report the Board said:

In broad terms, the public interest will be satisfied by an undertaking or action that will result over time in an enhancement of the economic or general welfare of the public. The public interest can be satisfied without improving the economic or general welfare of every member of society; indeed, it is possible that

the public interest in general can be satisfied even if some members of society are economically damaged. Essentially, one might interpret the public interest as the best possible accomodation of conflicting interests.

4.9 With the experience of these two Reports, the Board holds the view that it has produced a series of tests or measures against which a proposed transfer of the shares of a regulated utility can be examined. These include those itemized points contained in the introduction to this Report and, more specifically, those issues outlined in Chapter Three. In other words, if the Board can be satisfied on those points, it can safely conclude that an acquisition meets the the test of the public interest and will therefore be recommended to the Lieutenant Governor in Council for its approval.

4.10 In this case, the Board is of the opinion that the proposed Application is in the public interest, so long as the Board's recommended undertakings are accepted, because:

- o Gulf is sufficiently financially strong and the Board has accepted Mr. Kierans' opinion that New HWR will be sufficiently financially sound, such that Consumers' financial strength should not be impaired by the transfer of Consumers' shares from

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HWR to New HWR. Further, the interposition of 685515 Ontario Inc. between Consumers' and New HWR should have no effect on the utility's financial health providing the Board's recommendations on change of control are accepted; and

- o On an examination of the various factors involved, the Board is of the opinion that Consumers' will remain independent of its associates and that the customers, debt-holders and other shareholders will not be negatively affected by the changes set out in the Application.

- 4.11 The Board therefore recommends to the Lieutenant Governor in Council that leave be granted to permit the requested transfers on condition that the Board's recommended undertakings be entered into by the signatories.

Enforcement of Undertakings

- 4.12 The Board indicated in the Union/Unicorp Report its concern with the enforceability of undertakings given to the Lieutenant Governor in Council where leave is granted under subsection 26(2) of the Act. It recommended that all such undertakings be conditions of approval and that they should be treated as an order of the Board

and be monitored and enforced by the Board as such.

4.13 In this proceeding, Counsel for Gulf submitted that undertakings given by the parties under seal to the Lieutenant Governor in Council are enforceable in the same manner as contractual obligations.

4.14 Special Counsel submitted that undertakings given by the parties to the proposal should be incorporated in an Order of the Board and, therefore, would be enforceable by the Board within the terms of the Act.

The Board's Conclusions

4.15 Bill 142 is explicit on the authority of the Lieutenant Governor in Council to impose terms and conditions on any leave granted. Undertakings as known in the past will no longer exist. The Bill also provides for a monitoring role for the Board. In addition, where there is an alleged contravention of any term or condition, the Board may investigate such and report on it to the Minister of Energy. The enforcement of the terms and conditions is then in the hands of the Minister who can make application to the Supreme Court to deal with any contravention of a term or condition.

- 4.16 The Board has serious concerns regarding the legal enforceability of undertakings as they exist today. The Board is of the opinion that the provisions for the enforcement of undertakings contained in Bill 142 meet the concerns expressed by the Board in previous acquisition hearings. The Board therefore recommends that the undertakings recommended in this proceeding should be made terms and conditions of approval when the Bill becomes law, as is provided in the proposed legislation.

Signatories to the Undertakings

- 4.17 Special Counsel submitted that the undertakings should be entered into by Gulf, New HWR, 685515 Ontario Inc., and Consumers' itself which, he argued, would improve the prospects of enforcement. Mr. Sharpe disagreed with this submission as far as including Consumers' as a signatory to the undertakings; he pointed out that it was being included only because of its relationship with its major shareholder and it was not obtaining any benefit.
- 4.18 The Applicant also stated that the signatories should be bound severally and not jointly. Special Counsel disagreed and submitted that all signatories should be responsible for the enforcement of the undertakings on a joint and several basis.

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The Board's Conclusions

4.19 The Board accepts Special Counsel's submissions and therefore recommends that Gulf, New HWR, 685515 Ontario Inc. and Consumers' all be parties to the undertakings given to the Lieutenant Governor in Council because:

- o All the companies are closely related and controlled by very few people;
- o As a result of the interposition of 685515 Ontario Inc., the approval provisions of the Act could be effectively by-passed; and
- o Many of the undertakings are worded so as to impose an obligation on Consumers' to do or not to do something.

4.20 The Board recommends that the signatories be bound jointly and severally. It is the opinion of the Board that it is essential for all parties to act in concert having regard for the actions of the other signatories and that all parties be responsible for the enforcement of undertakings.

REPORT OF THE BOARD

5. SUMMARY OF THE BOARD'S CONCLUSIONS AND RECOMMENDED UNDERTAKINGS

In this Report, the Board has made a number of conclusions with respect to the issues relating to the Application and has recommended certain undertakings to be entered into by the signatories. This Chapter summarizes those conclusions and recommended undertakings.

Financial Soundness of Parent

Conclusions:

THAT Gulf is sufficiently sound financially such that the financial integrity of Consumers' should not be impaired (Paragraph 3.15);

REPORT OF THE BOARD

THAT the Board accepts Mr. Kierans' evidence that New HWR will be financially sound (Paragraph 3.16);

THAT the Board is not able to assess the financial soundness of 685515 Ontario Inc. at this time (Paragraph 3.16);

THAT the financial soundness of Consumers' proposed parents is sufficient to approve the proposed transactions provided that the Board's recommendations with respect to undertakings are accepted (Paragraph 3.17).

Independence of Consumers'

The Public Float

Conclusion:

THAT there are benefits of having a public float of common shares in a utility (Paragraphs 3.25 and 3.27).

Undertaking:

THAT no action will be taken to reduce Consumers' public float of common shares below 15 per cent without the prior approval of the Board (Paragraph 3.28).

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Consumers' Board of Directors

Conclusions:

THAT the independence of Consumers' Board of Directors is of the utmost importance (Paragraph 3.39);

THAT the definition of 'independent' should strive to achieve the objective of a person being governed solely by considerations relating to the best interest of Consumers' (Paragraph 3.39);

THAT this objective can be achieved by providing for both independence from management and economic independence of a majority of the members of the Board of Directors (Paragraph 3.39).

Undertakings:

THAT the majority of the Board of Directors of Consumers' be, at all times, "independent" of Gulf, Consumers' and their affiliates or associates (Paragraph 3.41);

THAT an independent director shall exclude the following persons:

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- o employees or officers of Consumers' or persons retained by Consumers';
- o employees, officers and directors of those companies affiliated or associated with Consumers';
- o persons in positions of "economic dependence", within the definition provided by the CICA;
- o persons who are "related parties", within the definition provided by the CICA; and
- o persons who own or control, directly or indirectly, more than 10 per cent of the shares of Consumers' (Paragraph 3.42).

THAT Consumers' auditors are to file with the Board, on the appointment of a new director and on an annual basis, a report indicating any related party transactions of Consumers' directors or situations of economic dependence and confirming that the majority of the Board of Directors is independent within the meaning of the previously described undertaking (Paragraph 3.43).

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The Auditors

Conclusion:

THAT the independence of Consumers' is of such importance that there should be no perception that the appointment of Consumers' auditors is, or could be, in any way influenced by the change in ownership of the utility's voting shares (Paragraph 3.47).

Undertaking:

THAT the auditors retained by Consumers' continue to be different than those retained by Gulf, New HWP and 685515 Ontario Inc. (Paragraph 3.48).

Head Office

Undertaking:

THAT the head office of Consumers' is to remain in Consumers' franchise area (Paragraph 3.50).

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Change of Control

Conclusions:

THAT any legislative change should require express approval of change of control of a gas utility's parent or grandparent (Paragraph 3.63);

THAT the Government needs to be assured that there will be no untoward effect on the performance of the utility in regard to its legal obligations to or its social contract with its customers and other members of the community (Paragraph 3.64);

THAT the leave of the Lieutenant Governor in Council should not necessarily be required at the point where the interference with private commercial transactions begins to outweigh the benefits of the review process (Paragraph 3.67);

THAT it is not necessary for 685515 Ontario Inc. to be a wholly-owned subsidiary of New HWR for the Board to recommend the approval of the transfer of Consumers' from New HWR to it, in view of the undertakings that the Board is recommending with respect to change of control (Paragraph 3.70).

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Undertakings:

THAT the signatories shall not take any action, without first obtaining leave of the Lieutenant Governor in Council, that will result in any person acquiring:

- (a) more than 20 per cent of the voting shares of Consumers'; or,
- (b) control of any person that owns or controls such voting shares of Consumers' where such shares constitute a significant asset of such person (Paragraph 3.68);

THAT "significant asset" shall be defined as follows: the voting shares of Consumers' shall constitute a significant asset of a person where the fair market value of the voting shares of Consumers' beneficially owned, directly or indirectly, constitutes 20 per cent or more of the aggregate book value of the total assets of such person determined on a consolidated basis in accordance with generally accepted accounting principles (Paragraph 3.68).

THAT an application for leave, as required by the above undertaking, shall be made to the Board, which will hold a public hearing and submit its opinion and report to the

Lieutenant Governor in Council (Paragraph 3.69);

Affiliated Transactions

Conclusions:

THAT the sale and transportation of natural gas by Consumers' to Gulf or any of its affiliates need not be the subject of an undertaking as such transactions are regulated by the Board in its normal rate-making process (Paragraph 3.84);

THAT it would be inappropriate to prohibit affiliated gas purchase transactions, but the Board will require prior approval of material gas purchases (Paragraph 3.85);

THAT the Board must be informed in advance of material affiliated transactions (Paragraph 3.86).

Undertaking:

THAT any affiliated transactions, other than the sale and transportation of gas by Consumers', aggregating \$100,000 or more annually relating to the supply of goods, services and information, including gas purchases, between Gulf and its affiliates

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or associates and Consumers' shall require prior approval of the Board (Paragraph 3.87).

Financial Integrity of Consumers'

Support Arrangements

Conclusion:

THAT the replacement of the current guarantees for the pre-1981 bondholders and preferred shareholders with either a bank guarantee or a guarantee of New HWR is sufficient to maintain the level of security accorded to Consumers' bondholders, debtholders and preferred shareholders (Paragraph 3.93).

Undertaking:

THAT any support arrangements existing after the reorganization whereby Gulf or its affiliates have guaranteed or supported the bonds, debentures, loans or preference shares of Consumers' shall not be altered without the prior approval of the Board (Paragraph 3.93).

Maintenance of Common Equity

Conclusions:

THAT the Board will not require a condition in the undertaking dealing with maintenance of common equity that a reasonable rate of return on equity capital be obtained (Paragraph 3.103).

THAT one of the many responsibilities of a parent company is to ensure that its subsidiaries have adequate equity at all times; this is particularly important in the case of a subsidiary which is a public utility (Paragraph 3.105)

Undertakings:

THAT the common equity of Consumers' is to be maintained at a level found appropriate by the Board in its rate decisions from time to time as set out in Special Counsel's undertaking (Paragraph 3.105);

THAT Consumers' shall raise or Gulf and/or its affiliates shall provide to Consumers', either directly or indirectly, within 90 days of an insufficiency of equity being identified, sufficient additional equity capital, provided that if Gulf and/or its

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affiliates supply such additional capital it shall be on terms no less favourable to Consumers' as those Consumers' could obtain directly in the capital markets (Paragraph 3.106).

Inter-corporate Indebtedness,
Guarantees and Investments

Conclusion:

THAT Consumers' be fully protected with respect to its future indebtedness, guarantees and investments (Paragraph 3.110).

Undertakings:

THAT Consumers' will not loan or advance funds to or guarantee or become responsible for the indebtedness or obligations of any firm, person, affiliate or subsidiary of Consumers' that is not regulated under the Act without the prior approval of the Board (Paragraph 3.111);

THAT Consumers' will not acquire or pay for securities of any person, firm or affiliate, associate or subsidiary of Consumers' that is not regulated under the Act without the prior approval of the Board (Paragraph 3.111).

Regulatory Issues

Golden Parachutes

Conclusions:

THAT golden parachute arrangements are in effect acquisition costs and should not find their way into Consumers' cost of service and rates (Paragraph 3.117);

THAT the costs of any golden parachutes be included in the recommended undertaking with regard to acquisition and reorganization costs (Paragraph 3.117).

Acquisition and Reorganization Costs

Undertaking:

THAT Consumers' will not include in its rate base or recover in its cost of service any of the acquisition or reorganization costs, including golden parachutes, incurred by the signatories in connection with the acquisition of shares of HWR or of shares of Consumers' by Gulf, New HWR or 685515 Ontario Inc. (Paragraph 3.120).

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Diversification

Conclusion:

THAT the Board shares the Government's concern that gas utilities ought to be insulated from the risks associated with non-utility activities (Paragraph 3.126).

Undertaking:

THAT Consumers' itself, or through a person it controls, shall not invest or participate in any activity that is not subject to the regulation of the Board without the prior approval of the Board, as provided in Section 37e of Bill 142 (Paragraphs 3.126 and 3.127).

The Public Interest

Conclusions:

THAT the proposed Application is in the public interest, so long as the Board's recommended undertakings are accepted (Paragraph 4.10);

THAT leave be granted by the Lieutenant Governor in Council to permit the requested transfers on condition that the recommended

undertakings be entered into by the signatories (Paragraph 4.11).

Enforcement of Undertakings

Conclusions:

THAT the provisions for the enforcement of undertakings contained in Bill 142 meet the concerns expressed by the Board in previous acquisition hearings (Paragraph 4.16);

THAT all recommended undertakings be made terms and conditions of approval when Bill 142 becomes law (Paragraph 4.16).

Signatories to the Undertakings

Conclusions:

THAT Gulf, New HWR, 685515 Ontario Inc. and Consumers' all be parties to the undertakings (Paragraph 4.19).

THAT the signatories be bound jointly and severally (Paragraph 4.20).

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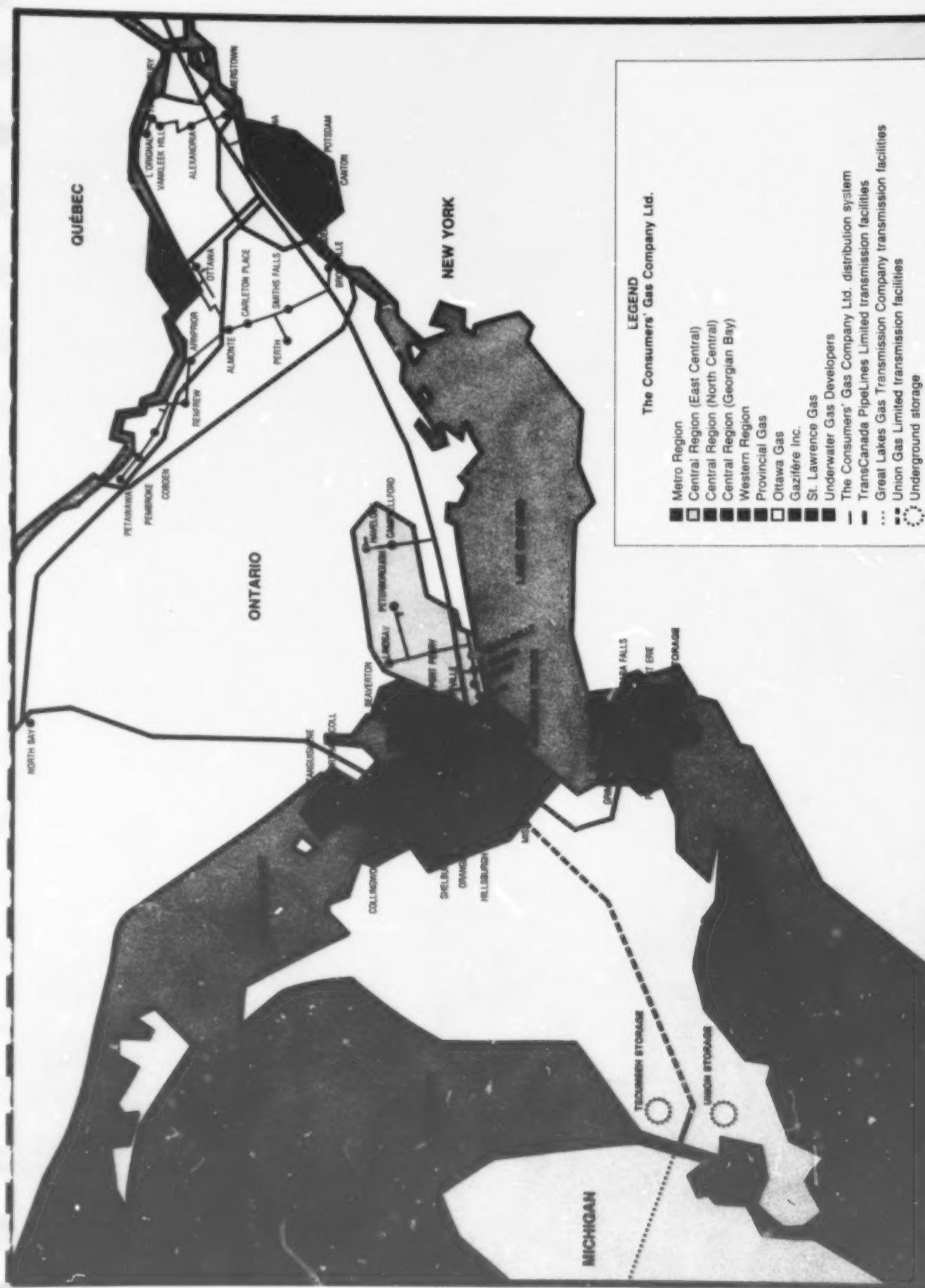
COSTS

The Board will issue an Order charging its costs for this proceeding to the Applicant.

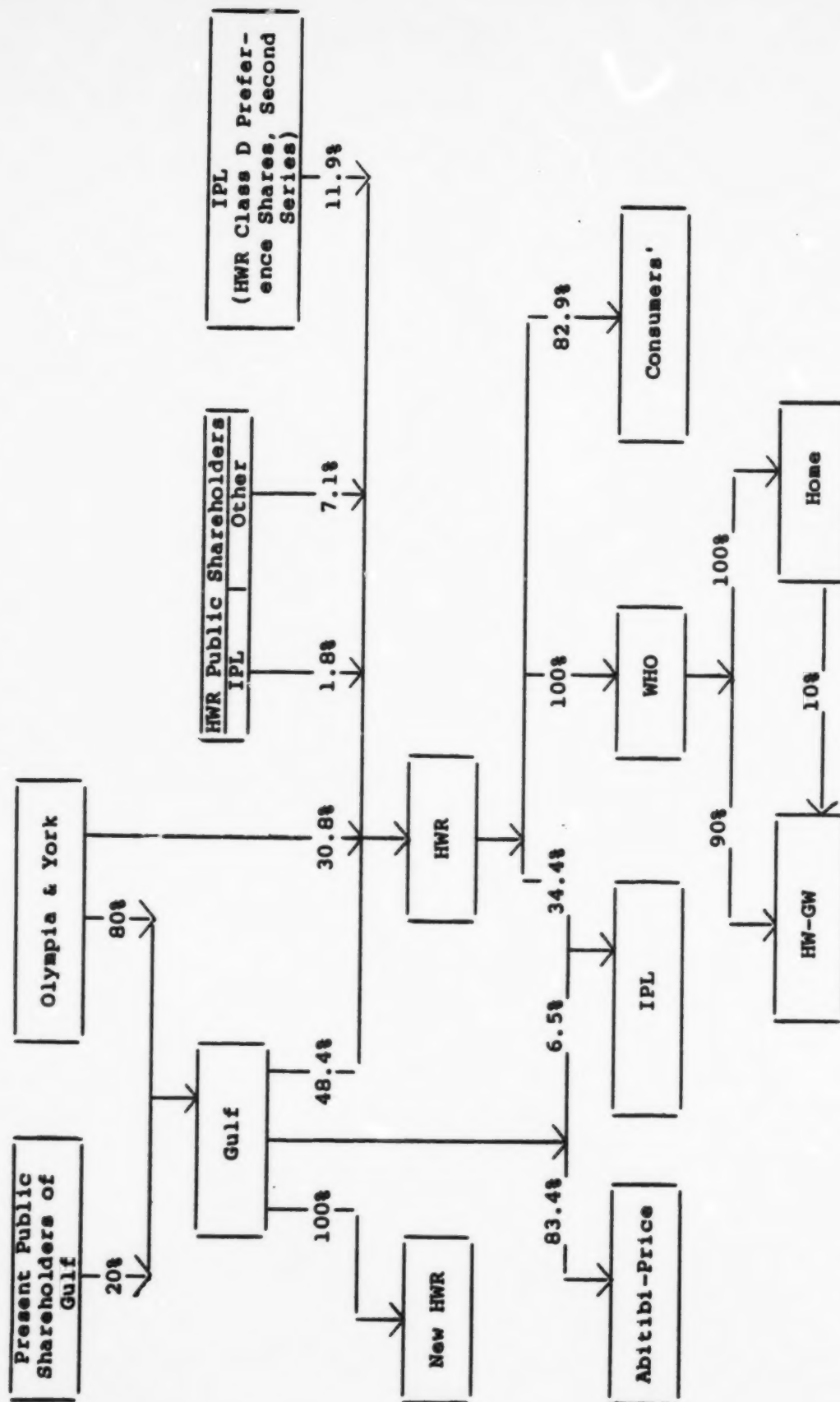
REPORT OF THE BOARD

APPENDIX A

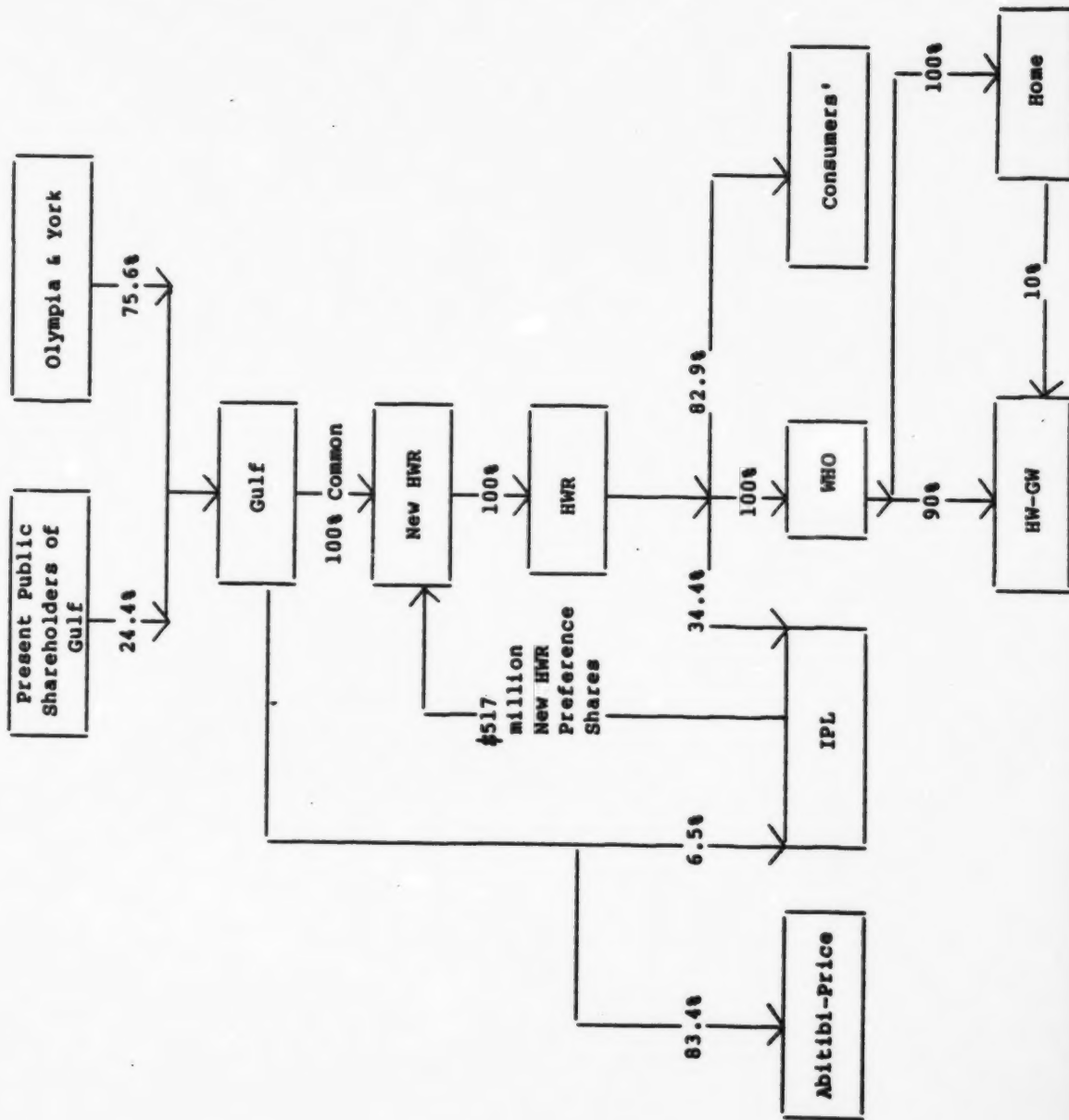
MAP OF CONSUMERS' DISTRIBUTION SYSTEM



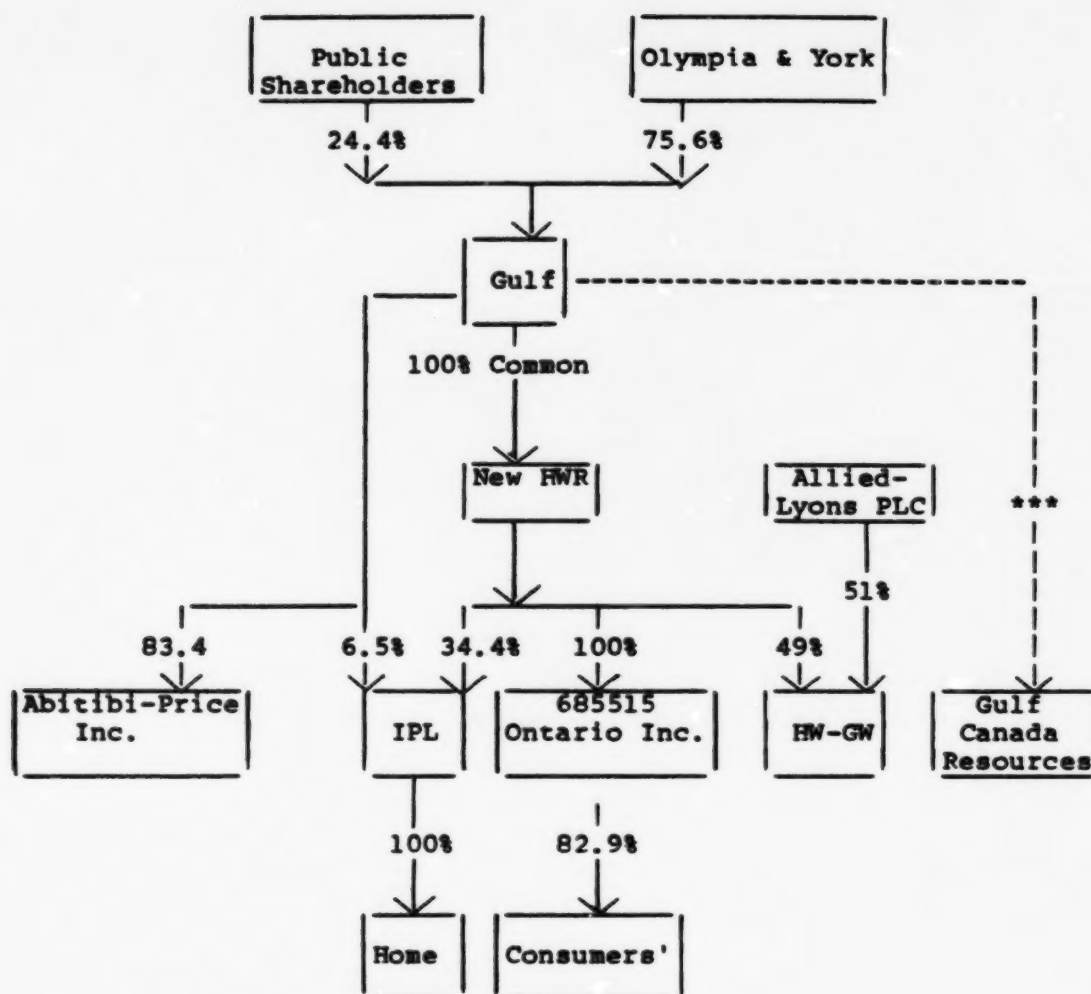
PRESENT CORPORATE STRUCTURE



CORPORATE STRUCTURE AFTER GIVING EFFECT
TO THE PLAN OF ARRANGEMENT



THE PROPOSED FINAL CORPORATE STRUCTURE



*** Gulf Canada Resources is a division of Gulf which operates independently with its own separate management and conducts Gulf's traditional upstream activities.

Proposed Undertakings

<u>Signatories</u>	<u>APPLICANT</u>	<u>SPECIAL COUNSEL</u>
	Gulf, New HWR, and 685515 Ontario Inc.; several responsibility and so long as each beneficially owns, directly or indirectly, a sufficient number of the issued and outstanding voting shares of Consumers' or of another corporation, including a Shareholder, to control Consumers', and so long as Consumers', itself or through a subsidiary, shall carry on the business of distributing natural gas in Ontario. Each shareholder agrees that it shall vote or cause to be voted any securities of Consumers' and of any other Shareholder beneficially owned, directly or indirectly, by it in order to give effect to the undertakings and agreements contained herein relating to actions to be taken or not taken by Consumers'.	Gulf, New HWR, 68515 Ontario Inc. and Consumers'; joint and several responsibility.
<u>Board of Directors</u>	The board of directors of Consumers' will be comprised of a majority of directors who are independent of Gulf and its associates (other than Consumers' and its associates) and who are	The majority of the Board of Directors of Consumers' shall at all times be independent of Gulf, Consumers' and affiliates or associates of the two companies. For the purpose of this under-

representative of the communities in which the utility business of Consumers' is carried on. It is understood that the term "representative" as used herein is not confined to persons who are elected or appointed officials of local government or agencies thereof.

For the purpose of this undertaking, a director of Consumers' shall be an independent director if he is not an employee, officer or director of Gulf or any of its associates (other than Consumers' and its associates).

Auditors

taking, independent shall mean a director who is not;

- (a) an employee, Director or officer of Gulf, its affiliates or associates (other than Consumers'); or
- (b) an insider of Gulf, Consumers' or its affiliates or associates within the meaning of the Ontario Securities Act or the Canada Business Corporations Act; or
- (c) required to report related party transactions or is in an economic dependence position within the meaning of Section 3840 of the Handbook of the Canadian Institute of Chartered Accountants; or
- (d) an employee, or officer of Consumers'.

Consumers' shall at all times retain as auditors an accounting firm that is not retained as an auditor by Gulf or any of its affiliates. Consumers' shall cause its auditors to file with the Board on an annual basis a report indicating any related party transactions between the Directors of Consumers' and Consumers', Gulf or its affiliates. This report must state that a majority of the Board of Directors are independent within the meaning of the above undertaking.

Affiliate Transactions

Consumers' will not enter into any agreement or transaction, whether or not in the ordinary course of business, with a Shareholder, or any associate of a Shareholder (other than a subsidiary of Consumers'), which is material to the business, operations or capital of Consumers' without the prior approval of a majority of those directors of Consumers' who are independent directors.

With the exception of the sale or transportation of natural gas by Consumers' to or for its residential, commercial and industrial customers, any material transactions relating to the supply of goods, services and information between Gulf and its affiliates or associates on the one hand and Consumers' on the other hand, shall be subject to the prior approval of the Ontario Energy Board and Consumers' shall file with the Energy Returns Officer on an annual basis a list of any inter-corporate transactions between Consumers' and any of its affiliated or associated companies where the quantum exceeded \$10,000 annually. Consumers' shall not purchase any of its gas supplies from Gulf, its affiliates or associates.

Head Office

Consumers' shall maintain its head office and main operating office within its franchise area.

At all times, Consumers' Head Office shall be maintained within Consumers' franchise area.

Support Arrangements

Any existing support arrangements whereby Gulf or its affiliates have guaranteed or supported, the bonds, debentures, loans or preference shares of Consumers' shall not be altered without the prior approval of the Ontario Energy Board.

Indebtedness,
Guarantees and
Investments

Consumers' shall not borrow for, make loans or advances to, pledge its assets as security for, guarantee the obligations of or otherwise assume or become responsible for the indebtedness or obligations of or otherwise make any investment in Gulf or other subsidiaries, affiliates or associates of Gulf (save and except for subsidiaries of Consumers') without the prior consent of the Ontario Energy Board.

Consumers' will not loan or advance funds to or guarantee or become responsible for the indebtedness or obligations of any firm, person, associate, affiliate, or subsidiary of Consumers' that is not regulated under the Ontario Energy Board Act without the prior approval of the Ontario Energy Board.

Consumers' will not acquire or pay for securities of any person, firm or affiliate, associate or subsidiary of Consumers' that is not regulated under the Ontario Energy Board Act, without the prior approval of the Ontario Energy Board.

Public Float of Common
Shares of Consumers'

Each Shareholder severally undertakes that it will not take any act which would result in less than ten per cent of the common shares of Consumers' issued and outstanding from time to time being held by persons other than the Shareholder and associates of such Shareholder without providing not less than ten business days prior written notice to the Ontario Energy Board of its intention to do so.

Consumers' or Gulf shall not take any action that will result in the votes attached to shares held by public shareholders who are not affiliates or associates of Gulf or Consumers' being less than fifteen per cent of the votes attached to all issued and outstanding securities of Consumers'.

The provisions of section 4.1 shall not apply to any

act which may be required as a result of the undertaking in section 3.1(b) hereof.

For the purposes of the undertakings and agreements contained herein, "control" shall mean the ownership of a sufficient number of this issued and outstanding voting securities of a corporation permitting the owner thereof to exercise control over the corporation through the ability to elect a majority of the directors of the corporation.

Change of Control

Subject to section 2.3 and section 2.4, each Shareholder severally agrees that it will forthwith provide to the Minister of Energy and to the Ontario Energy Board written notice of any potential change of control of the Shareholder or any other Shareholder, of which such Shareholder has knowledge, in circumstances where the Shareholder subject to the potential change of control owns common shares of Consumers' which constitute the principal asset of such Shareholder.

Each of Gulf and New HMR severally agrees that it will not enter into an agreement which would result in a change of control of New HMR, in the case of Gulf, or a change of control of 685515, in the case of

Gulf, New HMR, 685515 Ontario Inc. or Consumers' shall not take any action that will result in any person directly or indirectly, acquiring control of such numbers of any class of voting shares of Consumers' that together, with shares already controlled by such person or by such person and associates or affiliates of that person, will exceed 20 per cent of the outstanding voting shares, without leave of the Lieutenant Governor in Council. Application for such leave will be made to the Board, which shall hold a public hearing and submit its report and opinion to the Lieutenant Governor in Council.

New HMR, where the notice requirements of section 2.1 would apply unless such agreement provides that such a change of control will not occur earlier than ten business days after the Minister of Energy and the Ontario Energy Board have received written notice of such a potential change of control.

For the purposes of section 2.1, the ownership of common shares of Consumers' shall constitute a principal asset of a Shareholder where the fair market value of the common shares of Consumers' beneficially owned, directly or indirectly, by the Shareholder subject to the potential change of control constitutes not less than two-thirds of the aggregate fair market value of the total assets of such Shareholder determined on a consolidated basis in accordance with generally accepted accounting principles.

The notice requirements of section 2.1 shall not apply to any pledge, mortgage, encumbrance or other security interest on or in respect to common shares of Consumers' to secure a loan or indebtedness or to secure any bond, debenture or other evidence of indebtedness.

Equity of Consumers'

Consumers' shall retain such portion of the earnings of

There shall be retained in Consumers' such portion of

Consumers' as may from time to time be appropriate for retention by a gas distribution utility, and to the extent that, at any time, the retained earnings of Consumers' are not sufficient to maintain the equity of Consumers' at a level appropriate for a gas distribution utility:

- (a) Consumers' shall be free to raise equity capital from any source including the issuance of shares to the public without litigation from any Shareholder;
- (b) in the event that Consumers' is unable to raise equity capital sufficient for that purpose from outside sources the Shareholders shall provide, within a reasonable length of time, that equity capital to Consumers' directly provided that a reasonable rate of return on equity capital can be obtained.

Section 3.1(a) shall not be construed to require any Shareholder to underwrite or acquire all or any portion of any issue of securities of Consumers' or to guarantee or otherwise provide financial assistance for the benefit of any of the holders of any securities of Consumers'.

the earnings of Consumers' as may be appropriate from time to time for retention by a regulated gas distribution utility and to the extent that at any time, any such retained earnings are not sufficient to maintain the equity of Consumers' at the level approved or deemed appropriate by the Ontario Energy Board, Consumers' shall raise or, Gulf and/or its affiliates shall provide, either directly or indirectly, sufficient additional equity capital within ninety (90) days, provided that if Gulf or its affiliates provide such additional capital it shall do so on terms no less favourable to Consumers' as Consumers' could obtain directly in the capital markets.

Diversification

Consumers' shall not invest in or undertake any activity that is not subject to the regulatory jurisdiction of the Ontario Energy Board, without the prior approval of the Ontario Energy Board.

Enforcement

These undertakings shall be binding upon the successors and assigns of Gulf, New HWR, 685515 Ontario Inc. and Consumers' and any undertakings contained in the Order in Council approving the Application at issue, shall be incorporated in an Order of the Board, and shall be enforceable as an Order within the terms of the Ontario Energy Board Act.

Past Undertakings

The undertakings and agreements contained herein supersede and replace the undertakings given by HWR to the Lieutenant Governor in Council dated April 21, 1981.

These undertakings supercede and replace the undertakings dated April 21, 1981 given to the Lieutenant Governor in Council by Hiram Walker Resources Ltd.

685515 Ontario Inc.

The subsequent sale of the shares of Consumers' from New HWR to 685515 Ontario Inc. is approved only on the condition that 685515 Ontario Inc. remain a wholly owned subsidiary of New HWR and that 685515 Ontario Inc. is bound by these undertakings.

Associates and
Affiliates

The term "associate" as used herein has the meaning ascribed thereto in paragraph 1(1)4 of the Business Corporations Act, 1982 in force

For the purpose of these undertakings the term "associates" and "affiliates" shall be defined as in sections 1(1)4, and 1(4) of

on the date hereof.

Business Corporations Act,
1982.

Acquisition and
Reorganization Costs

Consumers' will not include in its rate base or recover in its cost of service any of the acquisition or reorganization costs incurred by any Shareholder in connection with the acquisition of shares of HWR or of shares of Consumers' by any Shareholder.

Consumers' will not include in its rate base or recover in its cost of service any of the acquisition or reorganization costs incurred by Gulf, New HWR or 685515 Ontario Inc. in connection with the acquisition of shares of HWR or of shares of Consumers' by Gulf, New HWR or 685515 Ontario Inc.

Approval

Any approval or consent of the Ontario Energy Board referred to in or contemplated by these undertakings and agreements may be given by the Ontario Energy Board without a hearing.